

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

A SERVICE AGREEMENT BETWEEN NEWPORT)	
STEEL CORPORATION AND THE UNION)	CASE NO. 90-068
LIGHT, HEAT AND POWER COMPANY)	

O R D E R

On September 27, 1990, the Commission issued an Order denying the proposed service agreement between The Union Light, Heat and Power Company ("ULH&P") and Newport Steel Corporation ("NSC"). The proposed service agreement would have allowed ULH&P to serve NSC's existing and expanding load pursuant to modified versions of Rate TT and Rider LM over a 10 year term. The Commission based its decision to deny the proposed service agreement on two factors.

First, Article I of the proposed contract prohibited NSC from obtaining power and energy from any other supplier and from engaging in the cogeneration of electricity for the purpose of displacing power and energy provided by ULH&P. According to ULH&P, this provision was enacted in order to optimize the opportunity for ULH&P to recover its investment in new service facilities to serve NSC's expanded load. The Commission found that a contractual prohibition of cogeneration runs counter to both the Commission's express intent to encourage cogeneration and Title II of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), which established a clear public policy in support of cogeneration.

Second, Section 3.5 of the proposed agreement established a schedule of automatic rate increases to be implemented during the 10 year term of the contract. The rate increase schedule specified effective dates and rate increases which would have resulted in a total 20 percent increase over the term of the contract. According to ULH&P, this automatic rate increase schedule was developed to provide NSC with some assurance of rate stability in order to help justify NSC's investment in a new continuous caster facility at its Wilder, Kentucky plant. The Commission found that a schedule of automatic rate increases would not properly consider cost causation and would result in future rates being established without reference to cost-of-service studies. The Commission refused to grant pre-approval to automatic rate increases for any customer that are based on estimated costs with no supporting cost analysis or documentation.

On October 16, 1990, ULH&P filed an application for rehearing of the Commission's September 27, 1990 Order. Specifically, ULH&P seeks rehearing on the Commission's determination that: 1) the prohibition of cogeneration in Article I of the proposed service agreement could not be approved; and, 2) the schedule of automatic rate increases contained in Section 3.5 does not properly consider cost causation, has not been shown to result in rates that will be fair, just and reasonable over the term of the contract and must therefore be rejected.

In support of its application, ULH&P claims that the Commission's September 27, 1990 Order will negate the benefits of the proposed service agreement. ULH&P further maintains that should NSC choose to cogenerate some or all of its energy requirements ULH&P would be deprived of the opportunity to earn a return on its investment, its system load factor will be adversely affected and the time period during which its existing retail rates are sufficient would be shortened to the detriment of all of ULH&P's customers. ULH&P contends that the rates incorporated within the proposed service agreement cannot and will not result in future rates for NSC being established without reference to cost-of-service studies. According to ULH&P, Section 3.5.f. provides evidence that the proposed service agreement does not provide for automatic rate increases without cost-of-service considerations. This subsection reads:

The increases provided for herein shall not result in rates which exceed the rates approved by the Kentucky Public Service Commission for the same retail service, throughout the term of this contract.

ULH&P contends that the increases to NSC will not occur until and unless increases of the same magnitude or greater have previously been approved by the Commission for the same retail service. Therefore, according to ULH&P, future rates for NSC will be established with reference to cost-of-service studies.

The Commission recognizes the importance, for ULH&P and all its customers, of providing an opportunity for ULH&P to earn a return on its investment in facilities to serve NSC, the improvement of ULH&P's system load factor, and the extension of

the time period during which ULH&P's present retail rates will provide the opportunity to earn a fair return. The Commission, however, is not convinced that the appropriate way to achieve these goals is through the imposition of a prohibition of cogeneration. ULH&P and NSC should negotiate an alternative solution which will address and satisfy the needs of both parties without limiting the resource options of either. Examples of methods that could be considered include a contribution in aid of construction, monthly facilities charge, or a termination charge.

The Commission remains firm in its intent to encourage the development of cogeneration projects in Kentucky. ULH&P's application for rehearing presents neither evidence nor arguments not previously considered. For this reason, the Commission will not grant rehearing on Article I of the proposed service agreement.

ULH&P has directed the Commission's attention to Section 3.5.f. as evidence that the proposed service agreement does not provide for automatic rate increases without reference to cost-of-service. This provision, in effect, establishes a cap or maximum on the rates that can be charged to NSC over the term of the agreement. This cap would be set at the rates approved by the Commission for customers using the same class of service. ULH&P asserts that this provision mitigates the Commission's concern that a current schedule of automatic rate increases will establish a customer's rates for 10 years into the future without the benefit of supporting cost analysis or documentation and will not result in rates that are fair, just, and reasonable over the

entire term of the contract. The Commission disagrees with ULH&P's assertion.

Whereas the Commission is concerned that rates for one customer do not exceed those approved for others in the same class of service, the Commission is equally concerned that rates for one customer not be set below those charged to others in the same class of service without sufficient cost-of-service justification and documentation.¹ Neither Section 3.5.f., nor any other provision of the proposed service agreement, sufficiently addresses the real potential that NSC's rates could fall below standard tariffed rates without the required cost-of-service justification and documentation. This would result in rates which are not fair, just, and reasonable. The Commission finds that ULH&P has failed to justify a rehearing of the Commission's decision to reject Article III, Section 3.5, of the proposed service agreement.

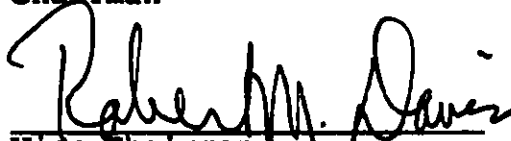
IT IS THEREFORE ORDERED that ULH&P's application for rehearing be and hereby is denied.


¹ The Commission's Order dated September 24, 1990, in Administrative Case No. 327, An Investigation into the Implementation of Economic Development Rates by Electric and Gas Utilities, requires detailed cost-of-service analysis and documentation supporting discounted rates for new and existing large commercial and industrial customers.

Done at Frankfort, Kentucky, this 1st day of November, 1990.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director